CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM STATEMENT OF INVESTMENT POLICY FOR

HAZARDOUS MATERIALS IN REAL ESTATE INVESTMENTS

August 19, 2002

This Policy is effective immediately upon adoption and supersedes all previous real estate hazardous materials policies.

I. PURPOSE

This document sets forth the investment policy ("this Policy") for property contaminated by hazardous materials in the real estate investment program ("the Program"). This Policy will require investment managers, advisors, partners and other participants (the foregoing are referred to in this Policy collectively as the "investment manager") selected by the California Public Employees' Retirement System ("the System") to take prudent action with respect to hazardous materials, consistent with their fiduciary duties to the System and in compliance with environmental laws, in the execution of the Program. This Policy allows reasonable flexibility in assessing and mitigating environmental risks to capture investment opportunities for the Program.

II. STRATEGIC OBJECTIVE

The strategic objective of this Policy is to minimize liability under environmental laws that may be incurred by the System through the Program.

III. ENVIRONMENTAL LAWS

This Policy is necessary because the costs of clean-up and other liabilities created by environmental laws in purchasing, leasing or disposing of, or making a loan secured by, real property contaminated by hazardous materials may have a significant effect on the investment return to the System. Liability for environmental contamination is a dynamic legal field that has expanded rapidly and continues to change. The investment manager needs to be aware of significant developments in the law as they occur. The landmark federal environmental law known as "Superfund" or "CERCLA" (Comprehensive Environmental Response, Compensation and Liability Act) imposes liability on owners of real property contaminated by hazardous materials, regardless of whether the current owner was responsible for the initial contamination. Under CERCLA, an owner may, however, avoid liability if the owner undertook "all appropriate inquiries" into the previous ownership, uses and condition of the property. Most states have also enacted statutes imposing liability for hazardous materials contamination (see, e.g., California Health and Safety Code Sections 25300, et seq.), and all states have traditional tort law doctrines that may apply to

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real property contamination. State law may also require an owner who knows (or should know) that the property is contaminated by hazardous materials to give written notice of the contamination to a tenant or a buyer of the real property, and the owner may be liable to a tenant or a buyer for any failure to disclose the contamination (see, e.g., California Health and Safety Code Section 25359.7).

New laws are created to address the potential adverse human health effects of environmental conditions associated with the use of real property. For example, legal standards have begun to emerge with respect to the presence of molds which may be hazardous to human health (see, e.g., New York City Department of Health, Guidelines on Assessment and Remediation of Fungi in Indoor Environments (November 2000); and U.S. Environmental Protection Agency, Mold Remediation in Schools and Commercial Buildings (March 2001)). California's Mold Protection Act of 2001 imposes an immediate duty on commercial and industrial landlords, who have notice of the presence of mold or water intrusion, both to assess the presence of mold (or conditions likely to cause it) and to conduct necessary remedial action. Some of the hazardous materials that may contaminate real property and create liability for an owner or a lender are described in Section VI of this Policy.

IV. ACQUISITIONS, FINANCINGS AND DISPOSITIONS

The guidelines in this Section apply to all acquisitions and dispositions of real property made by the System directly or through co-investment ventures with partners and to all loans held by the System directly or through participation arrangements in which the System has an interest in the real property (which excludes investments in securities supported by mortgage pools).

A. Acquisitions and New Loans

- 1. To minimize the risk of loss and the potential liability that the System might incur, the System shall not make acquisitions of, or loans secured by, real property contaminated by hazardous materials except as set forth in this Section.
- 2. Before each acquisition or loan, the investment manager shall appropriately investigate potential hazardous materials contamination in a "due diligence" review of the real property. The purpose of the investigation will be to assess environmental risk and, if it exists, to determine whether appropriate environmental risk mitigation measures are available to address it.
- 3. The results of the investigation shall be contained in a written report.
 - In general, the investigation and report should include a "Phase I Environmental Site Assessment" conducted by a qualified consultant(s) experienced in hazardous materials

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inspections and surveys, which complies with the standards for "all appropriate inquiries" established pursuant to CERCLA. The report should include the following information:

- (1) The results of an inquiry into the identity of previous owners and tenants and the nature of prior and existing uses of the real property to identify the potential for contamination on or about the real property;
- (2) Commonly known or reasonably ascertainable information about the obvious or likely presence of contamination on or about the real property; and
- (3) A summary of all publicly available governmental records and reports (including building records) with respect to the environmental condition of the real property.
- b. The investment manager may determine, based on the report, considering the character of the property, and taking into account the advice and recommendations of the consultant(s), that the scope of the investigation should be expanded, which may include the following tests for hazardous materials:
 - (1) Building air quality sampling and analysis;
 - (2) Sampling and analysis of building materials for the presence of asbestos and other hazardous materials (specifying, if asbestos or other hazardous materials are found, the identification of the building and the area within the building containing asbestos or other hazardous materials, and whether efforts have been made to remediate the asbestos or other hazardous materials);
 - (3) Surface and subsurface soil tests;
 - (4) Surface water and groundwater quality tests; and
 - (5) Sampling and analysis of building materials, occupied spaces, HVAC systems, and indoor air for infestation of molds, other fungi or bacteria, or other microorganisms that may pose a risk of adverse effects on human health (specifying, if infestation is found, the location, extent and magnitude, the source

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or contributing conditions, the foreseeable growth if unremediated, and whether remediation efforts have been made).

- Real property that is found to be contaminated by asbestos, molds 4. or other hazardous materials may be acquired or used as security for a loan when the investment manager concludes, in the exercise of reasonable judgment consistent with good industry practices and based on the advice and recommendations of the consultant(s) and, if appropriate, advice of staff and legal counsel, that (a) mitigation measures are already in place or can be implemented by the investment manager to effectively mitigate the risks to the System and (b) with such measures, the real property will yield an appropriate risk-adjusted rate of return to the System. mitigation measures could include removal of the hazardous materials; a "no further action" or "closure" letter or a covenant not to sue (such as a "Prospective Purchaser Agreement") from the pertinent government agency; an indemnity or undertaking from a financially responsible party who has assumed responsibility for the contamination; environmental insurance covering the risk of loss; or a comparable mechanism that mitigates environmental liabilities associated with the hazardous materials or permits residual contamination to remain on the property without further corrective The investment manager will be responsible for implementation of the required mitigation.
- 5. To the extent it is feasible under the circumstances of the investment, the seller or borrower should (a) represent and warrant that the real property is not contaminated by hazardous materials and does not violate any environmental laws and (b) indemnify the System against and hold the System harmless from any damage or liability from environmental contamination.

B. Existing Loans

- 1. Refinance or Extension of Loan
 - a. No existing loan shall be refinanced or extended unless the investment manager has completed the investigation required for acquisitions and new loans in accordance with Section IV.A.3 of this Policy to determine whether hazardous materials are present on the real property.
 - b. An existing loan shall not be refinanced or extended if hazardous materials are present on the real property security for the loan, unless the investment manager either concludes that mitigation measures are already in place or

can be carried out in accordance with Section IV.A.4 of this Policy or determines, taking into account the results of the investigation and advice of staff, legal counsel and consultants, that:

- (1) the refinancing or extension will substantially decrease the potential risk of loss and liability that will be incurred by the System in the event that the borrower cannot obtain other financing and defaults on the loan, and
- (2) the refinancing or extension will enable the borrower to remove or effectively mitigate the effects of the contamination.

If it is concluded that such a loan should be refinanced or extended, a condition to such refinancing or extension shall be that the borrower undertake to remove or effectively mitigate the effects of the contamination as described in Section IV.A.4 of this Policy.

2. Default on Existing Loan

- a. Upon default under an existing loan secured by real property, reasonable efforts shall be made to induce the borrower to cure the default. If the borrower fails to cure the default, the investment manager shall complete the investigation required to be prepared for acquisitions and new loans in accordance with Section IV.A.3 of this Policy to determine whether hazardous materials are present on the real property.
- b. If, after such investigation, it is determined either that hazardous materials are not present or that mitigation measures are already in place or can be carried out by the System after acquisition of the real property in accordance with Section IV.A.4 of this Policy, then normal actions to collect the debt and enforce the System's rights in its security may be undertaken.
- c. If such investigation indicates that the real property security is contaminated by hazardous materials, an analysis shall be made of the potential risk of loss and liability that will be incurred by the System if it acquires ownership of the real property security through foreclosure. The System shall complete a foreclosure and acquisition of such real property only if such analysis indicates that the risk of loss and

potential liability is acceptable in relation to the size of the debt and the probable recovery of the investment by the System.

C. Dispositions

- 1. When the decision to sell real property has been made, the investment manager shall become familiar with the environmental condition of the real property. In some cases (e.g., where the real property may have been contaminated by hazardous materials after the acquisition by the System or the co-investment venture), it may be prudent to conduct a baseline environmental assessment, similar to the investigation described in Section IV.A.3 of this Policy, to establish the existence or level of contamination at the time of the sale.
- 2. In all cases, the investment manager shall (a) take into account any environmental liability issues in selling the real property, (b) make all disclosures to the buyer required by law, and (c) use reasonable efforts to minimize the post-closing liability of the System or the co-investment venture by, to the extent feasible, disclaiming any representations or warranties concerning environmental contamination of the real property, avoiding any indemnification of the buyer for environmental liabilities, and selling the real property on an "as is" basis.

V. ASSET MANAGEMENT

The investment manager responsible for the management of real property in the Program shall implement reasonable measures to ensure that the System's investments are operated and maintained in ongoing compliance with legal obligations related to hazardous materials. These measures may include the following, as appropriate for each asset, on a continuing basis:

- A. Collect and analyze information:
 - 1. Environmental reports, including any investigation pursuant to Section IV.A.3 of this Policy.
 - 2. Tenant information, including pre-leasing questionnaires.
 - 3. Information obtained during physical inspections of the site.
 - 4. Information developed in response to environmental incidents on the site
- B. Comply with regulatory requirements:

- 1. Timely issuance and renewal of environmental permits.
- 2. Timely submission of required information disclosures.
- 3. Periodic monitoring of tenants' activities and environmental compliance.
- 4. Prompt follow-up on identified noncompliance issues.

C. Manage environmental conditions:

- 1. Appropriate training of management personnel in environmental emergency response procedures, including reporting requirements.
- 2. Inclusion of environmental factors (e.g., inspections of storage tanks, asbestos-containing materials, and mold conditions) in routine maintenance and repairs.
- 3. Inspection of tenants' premises, and identification and remediation of adverse environmental conditions, prior to lease termination.

VI. HAZARDOUS MATERIALS GLOSSARY

Some of the common hazardous materials that may contaminate real property and create liability for the owner are listed below. This list is not exhaustive. Other substances may be of equal or greater concern.

Molds, Fungi, Bacteria and Other Microorganisms.

Molds are forms of fungi that live on plant or animal matter and in indoor environments, frequently in water-damaged building materials such as gypsum wallboard, carpeting, wood and ceiling tiles. Molds thus can be found in residential, commercial or industrial structures. Potential sources of moisture that can lead to mold infestation include leaking pipes, flood damage, leaking windows and roofs, HVAC leakage, sewage backup, and inadequate ventilation.

Asbestos.

Asbestos is a mineral which formerly was widely used in building construction, particularly in insulation, roofing felts, fire-resistant drywall, and acoustical products.

Lead.

Lead-based paint, and drinking water contaminated by lead-containing pipes or fixtures, are the most common sources of lead exposure.

Polychlorinated Biphenyls (PCBs).

PCBs formerly were widely used as insulating fluids in electrical transformers and capacitors, and in fluorescent light ballasts.

Radon.

Radon gas, a decay product of radium, is found as a natural component of rock and soils.

Petroleum Compounds and Chemicals in Storage Tanks.

Both above ground and under ground storage tanks are widely used at residential, commercial and industrial sites for storing fuels, chemical raw materials, pesticides or lawn care products, waste oils, and other hazardous substances and wastes.

To the extent the investment manager believes it is appropriate to do so, the investigation required by Section IV.A.3 of this Policy should include the foregoing hazardous materials.